

# Tax Reporting Aggressiveness and Its Relation to Aggressive Financial Reporting

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*The Accounting Review* (2009) 84 (2): 467-496.

<https://doi.org/10.2308/accr.2009.84.2.467>

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**ABSTRACT:** We investigate the association between aggressive tax and financial reporting and find a strong, positive relation. Our results suggest that insufficient costs exist to offset financial and tax reporting incentives, such that nonconformity between financial accounting standards and tax law allows firms to manage book income upward and taxable income downward in the same reporting period. To examine the relation between these aggressive reporting behaviors, we develop a measure of tax reporting aggressiveness that statistically detects tax shelter activity at least as well as, and often better than, other measures. In supplemental stock returns analyses, we confirm that the market overprices financial reporting aggressiveness. We also find that the market overprices tax reporting aggressiveness, but only for firms with the most aggressive financial reporting.

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